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Does the Federal Estate Tax Jeopardize Farm and Ranch Businesses?

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Does the Federal Estate Tax Jeopardize Farm and Ranch Businesses?

-by Neil E. Harl*

The publication of several studies on who pays federal estate tax and, specifically, the impact on farm and ranch businesses¹ has heightened interest in the 2001 law mandating repeal of the federal estate tax after 2009² at a time when the Congress is trying to craft a compromise provision.³ The recently published studies have demolished the myth that farm and ranch businesses are in jeopardy from the federal estate tax.

CBO Study

A research report released by the Congressional Budget Office on July 7, 2005,⁴ used 2000 tax data but applied 2005 law (a \$1.5 million applicable exclusion amount⁵ to the 2000 data to determine how many estates (including farm estates) would have to file federal estate tax returns.⁶ With an applicable exclusion amount of \$1.5 million, an estimated 33,685 estates would have had to file a federal estate tax return but only 1,005 farm and ranch estates would have been required to file a Form 706 and only 300 farm and ranch estates would have had to pay any federal estate tax.⁷ The study went on to calculate how many estates would have had insufficient liquidity to pay the tax.⁸ For all estates, only 740 estates (out of 13,771 that were estimated to owe some tax) would have had insufficient liquid assets to pay the federal estate tax liability.⁹ For farm and ranch estates, only 27 estates out of the estimated 300 owing tax would have had insufficient assets to pay the federal estate tax liability.¹⁰ Moreover, the liquidity calculations did not include assets held in trust¹¹ so that the numbers actually overstate the liquidity problem.

Had the applicable exclusion amount been set at \$3.5 million in 2005, as is being discussed in the compromise discussions, only 187 estates would have had to file a federal estate return, only 65 would have owed any tax and only 13 would have had insufficient liquidity to pay the federal estate tax owed, not considering trust assets.¹²

Study by Burman, Gale and Rohaly

A research study by Burman, Gale and Rohaly, published in *Tax Notes* in 2005¹³ estimated that raising the applicable exclusion amount to \$3.5 million would reduce sharply the number of farms and small businesses that would be affected by the federal estate tax. The authors estimated that only an estimated 30 farm and ranch estates would have had to pay the tax.¹⁴

Study Using IRS Data from 2003

Overall, federal estate tax was paid by approximately 1.3 percent of all estates in 2003.¹⁵ Of the roughly 2.3 million deaths whose estates reported in 2003, 30,627 incurred federal estate tax liability.¹⁶ In that year, a total of \$20,655,481,000 was paid in federal estate tax which averaged about \$674,420 per estate.¹⁷

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The largest 505 estates (those with taxable estates exceeding \$20 million) paid an average of \$10,265,364 each in federal estate tax in 2003.¹⁸ The top 1329 (those with taxable estates exceeding \$10 million of taxable estate) paid an average of \$6,115,653 each.¹⁹ The largest 3486 (those with estates exceeding \$5 million in taxable estate) paid an average of \$3,542,703 each in federal estate tax.²⁰ This contradicts the oft-heard argument that wealthy decedents don't actually pay federal estate tax.

As for the impact on farms and ranches, out of the 30,627 taxable estates, 1966 reported some "farm property" in 2003.²¹ That is 0.085 percent of all deaths. Interestingly, the largest concentration of farm property was in the group of estates exceeding \$20 million in taxable estate. For that group, 61 estates reported farm property but the average was \$1,313,852 in value.²²

The IRS does not separately report farm real estate. Farm real estate is reported under the category of "other real estate." A report released by the Congressional Research Service on June 9, 2003²³ included an estimate of the amount of farm real estate included in the "other real estate" category. Approximately \$1.6 billion of the assets reported in the "other real estate" category is believed by CRS to be farmland. The CRS conclusion was that "farm assets and business assets represent a relatively small share of total taxable estate value. And, most of the farm and business assets in the estate tax base are concentrated in estates valued at or above \$10 million."²⁴

It would appear that data on "farm property" provide a better assessment of the federal estate tax on farm *businesses* than the estimates of farm real estate. Ownership of "farm property" indicates that the decedent or the decedent's entity or entities were likely engaged in a farming operation. A substantial part of the farm real estate held by decedents or their entities is likely leased to a farm business.

Asset Value at Death That is Untaxed

The argument is often leveled against the federal estate tax that the estate tax constitutes double taxation inasmuch as asset values at death have already been subjected to income tax during life. That is an incorrect assessment. Poterba and Weisbrenner²⁵ found that much of the value subjected to federal estate tax is unrealized appreciation in value. The authors determined that 37 percent of all value in estates above \$500,000 in value is unrealized gain.²⁶ Among estates valued at more than \$10 million, 56 percent of value is unrealized gain.²⁷

FOOTNOTES

¹ See notes 4, 13, 15, 23, 25 *infra*.

² Pub. L. 107-16, 115 Stat. 41 (2001).

³ See Harl, "Taxation of Capital Gains, Gains at Death, and Estates: Policy Considerations," 108 *Tax Notes* 7 (July 4, 2005); Harl, "Federal Estate Taxation of Farm and Ranch Estates," 14 *Agric. L. Dig.* 153 (2003) (utilizing 2001 IRS data).

⁴ Congressional Budget Office, "Effects of the Federal Estate Tax on Farms and Small Businesses," U.S. Congress, July 7,

2005.

⁵ I.R.C. § 2010(c).

⁶ *Id.*, Table 8.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ Burman, Gale and Rohaly, "Options for Reforming the Estate Tax," 107 *Tax Notes* 379 (April 18, 2005).

¹⁴ *Id.*

¹⁵ See Internal Revenue Service, "Statistics of Income, Estate Tax Data Tables, 2003" available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96442,00.html>.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² Harl, *supra* note 3, Table 1.

²³ Congressional Research Service, "Report for Congress – Asset Distribution of Taxable Estates: An Analysis," updated May 23, 2003.

²⁴ *Id.*

²⁵ Poterba and Weisbrenner, "The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death," in Gale, Hines, and Slemrod, eds., *Rethinking Estate and Gift Taxation* 422 (2001).

²⁶ *Id.*

²⁷ *Id.*

AALA ANNUAL AGRICULTURAL LAW SYMPOSIUM

The American Agricultural Law Association is holding its annual Agricultural Law Symposium on October 7 & 8, 2005 at the Country Club Plaza Marriott in Kansas City, MO. New this year is 165 minutes of farm and ranch taxation presentations on Friday, October 7. The presentations will be made by Neil E. Harl, Roger A. McEowen and Phil Harris. A special "Friday only" registration is offered to allow tax professionals to attend the Friday tax presentations without having to attend both days. More information can be found on the AALA web site <http://www.aglaw-assn.org> or by contacting Robert Achenbach, AALA Executive Director at RobertA@aglaw-assn.org or by phone at 541-485-1090.